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MEMORANDUM

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TO: Docket Control

FROM: Deborah R. Scott
Director
Utilities Division

Arizona Corporation Commission

DOCKETED

JAN 9 3 00

DATE: December 28, 2000

RE: STAFF REPORT ON PDM ENERGY, L.L.C. APPLICATION FOR A CERTIFICATE OF CONVENIENCE AND NECESSITY TO PROVIDE COMPETITIVE RETAIL ELECTRIC SERVICES AS AN ELECTRIC SERVICE PROVIDER PURSUANT TO A.A.C. R-14-2-1601 ET SEQ. (DOCKET NO. E-03869A-00-0268)

Attached is the Staff Report for the above referenced application. The Applicant is applying for approval to provide the following services:

- Electric Generation
- Reseller of Meter Reading Services
- Reseller of Metering Services

Staff is recommending approval of the application following a hearing.

DRS/EAA

Originator: Erinn Andreasen

Attachment: Original and Ten Copies

STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION

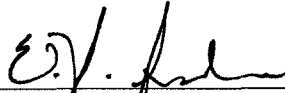
PDM ENERGY, L.L.C.
DOCKET NO. E-03869A-00-0268

APPLICATION FOR A CERTIFICATE OF CONVENIENCE AND NECESSITY TO
PROVIDE COMPETITIVE RETAIL ELECTRIC SERVICES AS AN ELECTRIC SERVICE
PROVIDER PURSUANT TO A.A.C. R-14-2-1601 ET SEQ.

December 28, 2000

STAFF ACKNOWLEDGMENT

The Staff Report for PDM Energy, L.L.C., Docket No. E-03869A-00-0268, was the responsibility of the Staff member listed below. Erinn Andreasen was responsible for the review and analysis of the Applicant's application for a Certificate of Convenience and Necessity to provide competitive retail electric services as an Electric Service Provider.



Erinn Andreasen
Economist

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1. INTRODUCTION

On April 21, 2000, PDM Energy, L.L.C. ("PDM" or "Company") filed an application for a Certificate of Convenience and Necessity ("CC&N") to provide competitive retail electric services as an Electric Service Provider ("ESP") in the State of Arizona.

Article XV, Section 2 of the Arizona Constitution and the Arizona statutes governing public service corporations give the Commission full power to regulate the State's public service corporations. Inherent in those powers is the authority to certificate public service corporations to provide competitive retail electric services and establish just and reasonable rates for these services. The Commission has rules, Title 14, Chapter 2, Article 16 of the Arizona Administrative Code, ("Retail Electric Competition rules"), that serve as a framework for processing applications to provide competitive retail electric services.

Staff's review of this application addresses the overall fitness of the Company to receive a CC&N.

2. APPLICATION FOR A CERTIFICATE OF CONVENIENCE AND NECESSITY

This section of the Staff Report contains descriptions of the geographic market to be served by PDM, its proposed services, and its technical and financial capabilities to provide the proposed services.

2.1 DESCRIPTION OF THE GEOGRAPHIC MARKET TO BE SERVED

PDM requests the authority to provide competitive retail electric services in all areas in the state that are determined by the Commission to be open to retail electric competition excluding the certificated areas of Morenci Water & Electric Company ("Morenci") and Ajo Improvement Company ("Ajo"), which are subsidiaries of PDM's ultimate parent company, Phelps Dodge Company ("Phelps Dodge").

2.2 DESCRIPTION OF PROPOSED SERVICES

The applicant is seeking Commission certification as an Electric Service Provider and as a Load Serving Entity. As a Load Serving Entity, PDM will reserve transmission and distribution services from the Utility Distribution Company ("UDC") in order to supply electricity to the customer's site. In its application, PDM indicated that it proposes to procure electric generation and offer it initially to large industrial customers.

PDM also intends to resell various metering services by contract with a Commission certificated ESP that may also be a Meter Service Provider ("MSP") or Meter Reader Service Provider ("MRSP"). PDM seeks authority to resell the MSP and MRSP services, because it is not currently seeking certification to perform the services itself.

PDM is required to acquire Commission approval in another CC&N application prior to providing the metering services itself.

In addition to offering various competitive retail electric services that require certification from the Commission, PDM will also offer its retail customers other non-certificated services such as financing options.

PDM does not own any electrical generating capacity and will acquire its load from the wholesale market.

2.3 FINANCIAL CAPABILITY TO PROVIDE THE PROPOSED SERVICES

PDM was incorporated in the State of Arizona on April 14, 2000. PDM is a wholly-owned subsidiary of Morenci Water and Electric Company which is in turn a wholly-owned subsidiary of Phelps Dodge. Phelps Dodge has submitted a statement of intent to provide financial support to PDM for the services set forth in the company's application. PDM has submitted the 1999 Annual Report of Phelps Dodge as proof of its financial capability to provide its services. The 1999 Annual Report lists assets of \$8.23 billion, total equity of \$3.28 billion, retained earnings of \$180.3 million and a net loss of (\$257.8) million on revenues of \$3.11 billion. Phelps Dodge had net income of \$190.9 million and \$408.5 million for 1998 and 1999 respectively. Based upon this information, Staff believes the Company has sufficient financial resources available to meet its capitalization requirements or incur operating losses. However, Staff recommends that Phelps Dodge clarify the extent to which it intends to provide financial support to PDM.

2.4 TECHNICAL CAPABILITY

PDM intends to utilize personnel of Phelps Dodge who have had significant experience in wholesale power acquisition, scheduling and delivery. Three contract energy management personnel have been identified in PDM's application. They have a combined experience in excess of sixty years in the areas of power management, procurement and metering for large industrial customers. These personnel will also manage any outside contractors related to procurement, metering or billing of competitive electric services. PDM plans to obtain additional technical expertise through new employees and consultants.

2.5 ESTABLISHING RATES AND CHARGES

A. Introduction

The electric competition rules establish a process for the introduction of competition in the provision of competitive electric services, manifested in a pricing policy that contemplates unbundled, competitive rates for all competitive services including generation of electricity and separate rates for the noncompetitive services of transmission and distribution of electricity.

A.A.C. R14-2-1611 (E) provides that an Electric Service Provider governed by Article 16 may price a competitive electric service at any level at or below the maximum rate stated in the company's tariff, provided it is not below the marginal cost of providing the service.

This pricing rule allows an Electric Service Provider to use flexible pricing for any of its competitive services. Flexible pricing is a desirable policy when alternative electric service providers are allowed to offer competitive services within the same service territory that has been opened for competition.

B. Proposed Tariff, Fair Value, Terms and Conditions of Service

The Applicant has submitted proposed tariffs. Applicant's response to Staff's requests for fair value information provides insufficient information for Staff analysis and recommendation for a fair value finding in this case. Without this information, Staff is unable to provide tariff analysis and recommendations in terms of a fair value finding. Therefore, Staff recommends that, if the Applicant wishes to proceed with its certificate application, any tariffs filed in this matter be approved on an interim basis. If a certificate is conditionally granted and tariffs are authorized on an interim basis, the Applicant should be required to file in this Docket, within 18 months of the date it first provides service following certification, sufficient information for Staff analysis and recommendation for a fair value finding, as well as for an analysis and recommendation for permanent tariff approval. This information must include, at a minimum, the following:

1. A dollar amount representing the total revenue for the first twelve months of electric service provided to Arizona customers by the Applicant following certification, adjusted to reflect the **maximum rates** that the Applicant has requested in its tariff. This adjusted total revenue figure could be calculated as the number of units sold for all services offered times the maximum charge per unit.
2. The total actual operating expenses for the first twelve months of electric service provided to Arizona customers by the Applicant following certification.
3. The value of **all assets**, listed by major category, used for the first twelve months of electric service provided to Arizona customers by the Applicant following certification. Assets are not limited to plant and equipment. Items such as office equipment and office supplies should be included in this list.

Staff further recommends that the Applicant's failure to meet the condition to timely file sufficient information for a fair value finding and analysis and recommendation of permanent tariffs shall result in the expiration of the certificate and of the tariffs.

PDM has indicated in its proposed tariff that the maximum rate charged for the provision of retail electric energy will be \$25 per kilowatt-hour. The rate proposed by PDM can be viewed as a reasonable maximum rate if the market will be competitive or if the market will transition to competition. Although PDM has proposed a maximum rate that is substantially higher than current rates, the effective price that PDM will likely charge is anticipated to be substantially lower than its proposed maximum rate due to the company's lack of market power and limited name recognition in Arizona. If approved, PDM will be one of several providers in the competitive market. If approved, PDM will likely be unable to

charge rates in excess of the Affected Utilities' standard offer rates, because the standard offer rates will be the prevailing and alternative prices.

PDM also intends to resell certain services, such as Meter Service and Meter Reading Service, to its Arizona customers. PDM has indicated in its tariff that the rate charged by the Commission-certificated Meter Service Provider, Meter Reading Service Provider or Utility Distribution Company will be passed through without markup to the customer.

PDM also intends to provide billing and collection services. PDM indicated in its proposed tariff that market-based billing and collection charges will be included in the charge for electricity supply. At this time, PDM has not filed a separate tariff charge for specialized billing and collection service charges.

Staff recommends that PDM submit a tariff setting forth a maximum price for specialized billing and collection services prior to providing any specialized billing and collection service in service areas regulated by the Commission.

C. Conclusion

PDM will be providing service in areas where an affected utility company is providing service. Therefore, PDM will have to compete with the existing electric service providers in order to obtain subscribers to its services. Because PDM will face competition in providing service to its potential customers, PDM will not be able to exert monopoly power. Thus, the competitive process will result in rates that are just and reasonable. However, Staff is not recommending permanent approval of PDM's tariff until a fair value determination has been completed.

2.6 OTHER APPLICATION ITEMS

A. Data Systems Management

PDM plans to use a variety of capabilities to exchange data with other market participants. These may include internet data posting and exchange, private line-type networks (such as frame relay), direct computer to computer file exchange (EDI) in prescribed ACC-authorized formats, fax transfer and other methods prescribed by the ACC.

PDM has indicated in its CC&N application that PDM will use commercial customer information system software to store and process customer account data. At this time, PDM does not own any computer equipment but will acquire the hardware and software necessary when it intends to offer service to Arizona customers. PDM intends to serve only a few large industrial customers and will not require computers capable of handling large volumes of customer account data.

B. Scheduling Coordinator

At the time of the filing of its application, PDM had not yet established a service acquisition agreement with a Scheduling Coordinator in Arizona as required in R14-2-1603(G)(3)(6).

Staff recommends that PDM's certification be conditioned upon PDM obtaining approval from the Director, Utilities Division, of its service acquisition agreement with a Scheduling Coordinator. Staff recommends that this approval be obtained prior to the provision of any competitive service.

C. UDC Service Acquisition Agreement

At the time of filing its application, PDM had not entered into a service acquisition agreement with any UDC in Arizona as required in R14-2-1603(G)(3)(6). As soon as a service acquisition agreement is negotiated with a respective UDC, Staff recommends that PDM provide that negotiated service acquisition agreement to the Director, Utilities Division for approval.

Staff recommends that PDM's certification be conditioned upon PDM obtaining approval from the Director, Utilities Division, of a service acquisition agreement with the UDC in each service area to be served. Staff recommends that this approval be obtained prior to the provision of any competitive service.

D. Code Of Conduct

A.C.C. R14-2-1616(A) requires each Affected Utility which plans to offer noncompetitive services and which plans to offer competitive services through its competitive electric affiliate to submit a Code of Conduct for Commission approval after a hearing. Morenci is an Affected Utility, and PDM would be its competitive electric affiliate. Therefore, Morenci needs to file its Code of Conduct.

Staff recommends that PDM's certification be conditioned on Commission approval of Morenci's Code of Conduct.

3. CUSTOMER SERVICE

PDM has stated in its application that it will not be collecting deposits or other funds in advance of providing services and, therefore, will not be required to provide a credit evaluation, security deposit or bond. However, if in the future PDM desires to charge its customers deposits or advances, Staff recommends that it comply with Commission policies regarding deposits and advances.

To address concerns of its customers concerning default or non-performance, PDM will provide proof to Staff that it has been found creditworthy by the UDC under its credit terms. Specific credit terms will be negotiated by PDM with the UDC. Staff recommends that, to guarantee or protect against any possible default or non-performance, PDM will

provide Staff with evidence indicating that the UDC has found it creditworthy prior to provision of any certificated service.

4. RECOMMENDATIONS

This section contains the Staff recommendations on PDM's application for a Certificate of Convenience and Necessity to provide competitive retail electric services. PDM is seeking certification as an Electric Service Provider to provide retail electric power service.

PDM will also provide meter service and meter reading service through a resale arrangement with a Commission-certificated provider of meter service and meter reading service.

While PDM is not requesting certification at this time to directly sell meter service and meter reading service, Commission approval is required for PDM to directly market these services and provide them to its customers as a reseller.

PDM does not own any electric generating capacity and will acquire its power from the wholesale market.

Based upon its technical capability and financial resources, Staff recommends that the Commission grant PDM's application for a CC&N to provide competitive retail electric service subject to the following conditions:

- a. PDM must either be its own scheduling coordinator, or have a service acquisition agreement with a Scheduling Coordinator before it provides service. The service acquisition agreement must be approved by the Director, Utilities Division, prior to the provision of service in a service area.
- b. PDM must have a service acquisition agreement with the Utility Distribution Company in each service area to be served that is approved by the Director, Utilities Division, prior to the provision of service in a service area.
- c. PDM will provide the Director, Utilities Division with evidence indicating that the UDC has found it credit worthy prior to provision of any certificated service.
- d. PDM's tariffs filed in this matter shall be approved on an interim basis.
- e. PDM shall not provide competitive services until the Commission approves a Code of Conduct for Morenci Water & Electric Company.
- f. PDM shall apply to the Commission for approval prior to provision of any other competitive service not approved at this time.
- g. PDM shall acquire all necessary licenses prior to providing service.

- h. PDM shall not be authorized to provide competitive service in the certificated area of an Affected Utility until the Commission has reached a final resolution in that Affected Utility's respective stranded cost filing.
- i. PDM shall, prior to providing any specialized billing and collection service in service areas regulated by the Commission, file a tariff setting forth a maximum price for specialized billing and collection services.
- j. PDM shall not provide services in the service areas of Morenci Water & Electric Company and Ajo Improvement Company.
- k. PDM shall acquire from Phelps Dodge a clarification of the extent to which it intends to provide financial support to PDM
- l. Applicant should be required to file in this Docket, within 18 months of the date it first provides service following certification, sufficient information for Staff analysis and recommendation for a fair value finding, as well as for an analysis and recommendation for permanent tariff approval. This information must include, at a minimum, the following:
 - 1. A dollar amount representing the total revenue for the first twelve months of electric service provided to Arizona customers by the Applicant following certification, adjusted to reflect the **maximum rates** that the Applicant has requested in its tariff. This adjusted total revenue figure could be calculated as the number of units sold for all services offered times the maximum charge per unit.
 - 2. The total actual operating expenses for the first twelve months of electric service provided to Arizona customers by the Applicant following certification.
 - 3. The value of **all assets**, listed by major category, used for the first twelve months of electric service provided to Arizona customers by the Applicant following certification. Assets are not limited to plant and equipment. Items such as office equipment and office supplies should be included in this list.

The Applicant's failure to meet the condition to file sufficient information for a fair value finding and analysis and recommendation of permanent tariffs shall result in the expiration of the certificate and of the tariffs.